BOARD OF TRUSTEES ENDOWMENT REPORT

to the

MIDDLEBURY COLLEGE
STUDENT GOVERNMENT ASSOCIATION

October 25, 2019

Please refer questions to:
Student Liaison to the SGA on Endowment Affairs (SLSEA) Elisa Gan
tgan@middlebury.edu

Meeting Overview.

On Friday, Oct 18, the Investment Committee of the Board of Trustees convened to review the financial returns of the 2019 fiscal year ending June 30, 2019. Representatives from Investure, LLC, to which Middlebury outsources its investment management, reported on the financial performance of the endowment. The board discussed the financial results and approved two changes in the liquidity parameters from the investment policies.

Fiscal Year 2019 Earnings.

Overall, the endowment experienced a healthy growth during the FY 2019 despite a major market downturn in December 2018. During this period, the endowment saw a 7.9% increase in return.[1] In comparison, the S&P 500 index increased by 10.4%. Many factors have driven the performance. On one hand, unemployment rate was low in the U.S., reflecting a continuing economic recovery. On the other hand, the ongoing trade war with China caused increasing uncertainty in the U.S. and Asia market. In the Europe market, Brexit has disturbed confidence and induced losses. Going forward, Investure's report suggests that the market volatility in U.S. is likely to increase. Conventional indications of recession have already appeared, such as the inversion of the bond yield curve.

The endowment currently stands at $1.1 billion. Key takeaways from the discussion include:

- Venture capital's robust performance accounted for almost half of the returns
- Private equities and public equities were the next biggest contributors
- Strategic asset allocation changes include: decreases in real assets and public equities and increases in private assets, liquid public assets and credit and private lending.

An issue of concern during the meeting was the long-term health of the endowment with the expectation of an upcoming recession. Currently, the inflow and outflow of the endowment are about equal. The 10-year annualized return net of inflation and fees is projected to be between 4.3% and 5.3%. In the meanwhile, the College targets a long-term spend rate of 5%, meaning that about 5% of the endowment is expected to be spent every year on the College's operation, excluding any discretionary spending withdrawn from a buffer fund accumulated from previous years, Therefore, the trustees raised questions about the thin margin between the return and spending rate. If the market increases in volatility and the returns experience a more significant

downturn, the endowment may decrease and damage the College's ability to sustain its operation.

In response to this issue, the College and the Board have made several efforts to improve the College's overall fiscal health in recent years. The annual spending rate has steadily declined to 5% and debt financing was restructured in order to reduce the amount of future interest payments. The outperformance of Investure in previous market downturns, such as the 2008 financial crisis, has also been discussed as a source of confidence.

The second concern of the meeting was whether the endowment has been too liquid at the expense of better returns. Previously, the College has four investment policies: 1) maximize 10-year net returns; 2) avoid being excessively conservative; 3) protect downside; and 4) maintain adequate liquidity. The fourth rule means that 30% of the endowment within one year and 60% within five years can be immediately "cashed out" if the need arises. But while offering safety, this liquidity requirement also limited the amount of endowment that can be put into some investments with higher returns. This year, private equities, which usually require multiple years of commitment before being cashed out, significantly outperformed the more liquid public equities. The trend is expected to continue. In order to increase the allocation in private equities, Investure made two recommendations to the fourth rule:

- Decrease the liquidity parameter from 60% to 50% (available in 5 years)
- Increase the percentage of maximum commitment and investment from 65% to 75%

The trustees discussed whether to maintain Middlebury's relatively conservative attitude of investment among its peer schools and to guard against recessions with a less liquid portfolio. In the end, the trustees voted to pass the motion.

Table 1. Endowment returns and major indices (one-year return as of 6/30/2019)

Middlebury College Endowment Returns	7.9%
S & P 500 TR	10.4%
MSCI All Country World	5.7%
MSCI Emerging Markets	1.2%

Table 2. Endowment balance 2017-2019

	FY 2017	FY 2018	FY 2019
Ending endowment balance	1074.0 million	1124.1 million	1113.4 million
Percentage of spending in endowment	5%	5%	5%

Table 3. Performance contribution by asset class (one-year return as of 6/30/2019)

Venture	3.7%
Public equity	2.2%
Hedge funds	1.4%
Real Assets	0.3%
Fixed Income	0.2%
Credit	0.0%

Divestment Update

In January 2019, Middlebury committed to a complete divestment from fossil fuels in 15 years. No new money will be invested in fossil fuels, and three mandatory incremental targets are to be met: 25% reduction by 2023, 50% by 2027 and 100% by 2034. The timeline of divestment was influenced by a series factors, including the natural maturity of transactions and the existing cycle of investment.

As of December 31, 2018, Middlebury has 5.1% of investment in fossil fuels, an equivalent of $ 56 million. The coal portion of exposure was 0.1%, a little less than $1 million. Since 2013, the fossil fuel investment has stayed rather flat. FY 2019 does not have a mandatory target, but representatives from Investure affirmed at the meeting that Middlebury is on track to meet its first goal in 2023. In addition, there have been multiple increases in exposure to sustainable investment. In line with the strategic move for a less liquid portfolio, 39% of the passive public may be moved to sustainability investments in private equities as opportunities arise. A detailed report about the divestment commitment over the first year period (Jan 2019 - Jan 2020) is expected to be released in May, 2020.

[1] Returns are measured by the accounting standards Investure's annual investment report. Numbers may differ from the final FY 2019 financial statement published by the College.